Level(3)
COMMUNICATIONS

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EX PARTE

June 8, 2012

Ms. Marlene H. Dortch, Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Re: Special Access NPRM, WC Docket No. 05-25 and RM-10593

Dear Ms. Dortch:

In its ex parte filed February 22, 2012, Level 3 argued that AT&T, Verizon and CenturyLink's (the "price-cap LECs") use of anticompetitive contracting arrangements to "lock up" 85-100% of their customers' prior special access expenditures in future periods, is unfair and unreasonable and therefore unlawful under Section 201(b) of the Act. Level 3 asked that the Commission declare these practices, as currently used, unlawful.

Recent ex partes filed by the price-cap LECs have attempted to distract the Commission from addressing the continuing problems rampant in the portion of the special access market that the Commission has not forborne from regulating by arguing that this portion of the special access market is shrinking, so the Commission should simply ignore it. The fact is that this is an 18 billion dollar market[1] that is operated in an anti-competitive manner by the price cap LECs, and, absent further action on the part of the Commission, will continue to be operated in that way for years to come. The continued materiality of this marketplace is evidenced quite clearly by the price-cap LECs vigorous efforts to avoid any actions by the FCC towards reforming it. While this letter primarily responds to questions raised by Commission staff during a February 28, 2012 ex parte meeting, Level 3 plans to separately address recent arguments made in this proceeding in the near future.

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1 *See* Letter from Charles W. McKee, Vice President – Government Affairs, Sprint to Ms. Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25; WT Docket No. 02-55 (filed May 29, 2012) at 2.

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During Level 3's ex parte meeting with Commission staff on February 28, 2012, the Commission staff raised the issue of the price-cap LEC's market power, particularly, whether a finding of market power must be made before the Commission can declare the price-cap LECs use of lock-up contracts unlawful. Level 3 addresses this issue in part II of this letter below.

The Commission staff also suggested, among other things, that Level 3 should put into the record additional data, specific to Level 3, evidencing either the lack of competition in the special access market, the price-cap LECs' exercise of market power in the special access market, or both. In response, please see part I of this letter, along with the supplemental information contained in Exhibit A to this filing, redacted as necessary to protect confidential information.

As of this filing, Level 3 purchases **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** of its DS1 special access service needs from the price-cap LECs. Similarly, Sprint filed an ex parte on April 24, 2012 (in opposition to the Verizon Wireless/SpectrumCo transaction) in which it said that approximately 90% of its existing TDM DS-1s are still provided by incumbent LECs.[2] That fact that vocal, large customers of the price-cap LECs like Level 3 and Sprint continue to begrudgingly purchase the vast majority of their special access needs from price-cap LECs is clear evidence of a problem in desperate need of a solution.

I. Evidence of Market Power Specific to Level 3

At Level 3's February 28, 2012 meeting, the Commission staff expressed interest in the following specific matters, each of which may be viewed as evidence of the market power of the price-cap LECs, the lack of competition in the special access market, or both.

Differential Pricing:

Consider the following real life examples:

Level 3 requires DS-1 service into a building located at **[BEGIN HIGHLY CONFIDENTIAL]** [redacted]

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2 Letter from David H. Pawlik, Counsel for Sprint Nextel Corp. to Ms. Marlene H. Dortch, Secretary, Federal Communications Commission, WT Docket No. 12-4 (filed April 24, 2012) ("April 24 Sprint Ex Parte") at 2.

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[redacted]"[3] **[END HIGHLY CONFIDENTIAL]** For DS-1 services subject to FCC granted Pricing Flexibility, Verizon has unilaterally raised its DS-1 pricing by approximately 6% within the last year, and attempted to raise its rates a second time by another approximately 8% in April, 2012[4] (but withdrew that proposed increase after many CLECs and others objected to it).[5] Conversely, CLEC DS-1's provided to this same building would cost Level 3 **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**. These CLEC prices have remained static for the last **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**.

Level 3 is unable to take advantage of lower CLEC prices (in locations where CLEC services are available) in Verizon territories, because Verizon, as a condition to providing Level 3 with discounts from highly inflated "rack rates," requires Level 3 to buy the vast majority of its special access needs from Verizon in Verizon territories. If Level 3 were to purchase more than a small fraction of its special access needs from CLECs or other competitive providers, it would be denied access to enormous discounts for the many connections that can only be obtained from Verizon[6] (and instead, would have to pay Verizon its highly inflated "rack rates" for all of the connections which only Verizon can provide). Level 3 must severely restrict its purchases from competitive suppliers, or risk paying very large "shortfall penalties" to Verizon for failing to meet its commitment to Verizon. Since Level 3 has no option but to buy many connections from Verizon in locations where Verizon is the only provider, Level 3's overall costs would

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3 *See* **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**

4 *See* Letter from Frederick Moacdieh, Executive Director, Federal Regulatory Affairs, Verizon to Ms. Marlene H. Dortch, Secretary, Federal Communications Commission, Transmittal No. 1187 (filed Apr. 30, 2012).

5 Verizon has said that the withdrawal of its most recent price increase was so that it could focus its efforts on convincing the Commission that "no additional regulations are necessary" in the special access proceeding. See Matthew S. Schwartz, Verizon Reverses Course, Withdraws petition to Raise Special Access Rates, Communications Daily, (May 15, 2012).

6 Section II of this letter below discusses the overwhelming number of locations at which there is no (or little) competitive choice for special access services other than the price-cap LECs.

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skyrocket unless it commits to buy all, or nearly all, of its connections in Verizon's territories from Verizon.

Similarly, Level 3 requires DS-1 service into a building located at **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** Conversely, a CLEC DS-1 provided to this same building would cost Level 3 **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** per DS-1, **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** and would only require a **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** term commitment. Level 3 cannot buy the DS-1s from a CLEC because of its **[BEGIN HIGHLY CONFIDENTIAL]** [redacted][8] **[END HIGHLY CONFIDENTIAL]** and without the commitment and corresponding discount provided in exchanged for making it, the additional cost to Level 3 of buying these connections would overwhelm any savings that Level 3 could realize by purchasing from CLECs at locations where their services are available.

Level 3 requires DS-1 service into a building located at **[BEGIN HIGHLY CONFIDENTIAL]** [redacted][9] **[END HIGHLY CONFIDENTIAL]** Conversely,

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7 *See* **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**

8 *See* **[BEGIN HIGHLY CONFIDENTIAL** [redacted] **[END HIGHLY CONFIDENTIAL]**

9 *See* **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**

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CLEC DS-1's provided to this same building would cost Level 3 **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** per DS-1, **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** less than AT&T's lock-up price and would only require a **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** term commitment.

Take these examples multiplied by tens of thousands of buildings and hundreds of thousands of DS-1's and DS-3s and the problem Level 3 faces with the price-cap LEC lock up plans starts to come in to focus. Almost ubiquitously, the pricing Level 3 observes in the marketplace from the price-cap LECs is dramatically higher for the same services to the exact same locations than the pricing Level 3 could obtain from competitive providers in those locations where competition is present. The chart below represents the pricing Level 3 experiences to identical addresses, for identical services as provided by the listed carriers in each city:

DS1 Pricing

Location—Single On-Net Customer Premise	Carrier	Term	Price
Dearborn, MI	AT&T	**[BEGIN HIGHLY CONFIDENTIAL]** [redacted]	[redacted] **[END HIGHLY CONFIDENTIAL]**
	AT&T	**[BEGIN HIGHLY CONFIDENTIAL]** [redacted]	[redacted] **[END HIGHLY CONFIDENTIAL]**
	Competitive Provider	**[BEGIN HIGHLY CONFIDENTIAL]** [redacted]	[redacted] **[END HIGHLY CONFIDENTIAL]**
	Competitive Provider	**[BEGIN HIGHLY CONFIDENTIAL]** [redacted]	[redacted] **[END HIGHLY CONFIDENTIAL]**
Denver, CO	CenturyLink	**[BEGIN HIGHLY CONFIDENTIAL]** [redacted]	[redacted] **[END HIGHLY CONFIDENTIAL**
	CenturyLink	**[BEGIN HIGHLY CONFIDENTIAL]** [redacted]	[redacted] **[END HIGHLY CONFIDENTIAL]**
	Competitive Provider	**[BEGIN HIGHLY CONFIDENTIAL]** [redacted]	[redacted] **[END HIGHLY**

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		year	**CONFIDENTIAL]**
	Competitive Provider	**[BEGIN HIGHLY CONFIDENTIAL]** [redacted]	[redacted] **[END HIGHLY CONFIDENTIAL]**
New York, NY	Verizon	**[BEGIN HIGHLY CONFIDENTIAL]** [redacted]	[redacted] **[END HIGHLY CONFIDENTIAL]**
	Verizon	**[BEGIN HIGHLY CONFIDENTIAL]** [redacted]	[redacted] **[END HIGHLY CONFIDENTIAL]**
	Competitive Provider	**[BEGIN HIGHLY CONFIDENTIAL]** [redacted]	[redacted] **[END HIGHLY CONFIDENTIAL]**
	Competitive Provider	**[BEGIN HIGHLY CONFIDENTIAL]** [redacted]	[redacted] **[END HIGHLY CONFIDENTIAL]**

DS3 Pricing

Location—Single On-Net Customer Premise	Carrier	Term	Price
Dearborn, MI	AT&T	**[BEGIN HIGHLY CONFIDENTIAL]** [redacted]	[redacted] **[END HIGHLY CONFIDENTIAL]**
	AT&T	**[BEGIN HIGHLY CONFIDENTIAL]** [redacted]	[redacted] **[END HIGHLY CONFIDENTIAL]**
	Competitive Provider	**[BEGIN HIGHLY CONFIDENTIAL]** [redacted]	[redacted] **[END HIGHLY CONFIDENTIAL]**
	Competitive Provider	**[BEGIN HIGHLY CONFIDENTIAL]** [redacted]	[redacted] **[END HIGHLY CONFIDENTIAL]**
Denver, CO	CenturyLink	**[BEGIN HIGHLY CONFIDENTIAL]** [redacted]	[redacted] **[END HIGHLY CONFIDENTIAL]**
	CenturyLink	**[BEGIN HIGHLY CONFIDENTIAL]** [redacted]	[redacted] **[END HIGHLY CONFIDENTIAL]**

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	Competitive Provider	**[BEGIN HIGHLY CONFIDENTIAL]** [redacted]	[redacted] **[END HIGHLY CONFIDENTIAL]**
	Competitive Provider	**[BEGIN HIGHLY CONFIDENTIAL]** [redacted]	[redacted] **[END HIGHLY CONFIDENTIAL]**
New York, NY	Verizon	**[BEGIN HIGHLY CONFIDENTIAL]** [redacted]	[redacted] **[END HIGHLY CONFIDENTIAL]**
	Verizon	**[BEGIN HIGHLY CONFIDENTIAL]** [redacted]	[redacted] **[END HIGHLY CONFIDENTIAL]**
	Competitive Provider	**[BEGIN HIGHLY CONFIDENTIAL]**[redacted]	[redacted] **[END HIGHLY CONFIDENTIAL]**
	Competitive Provider	**[BEGIN HIGHLY CONFIDENTIAL]** [redacted]	[redacted] **[END HIGHLY CONFIDENTIAL]**

Taking one (of many) examples from the above, but for the lock-up, there is no reason whatsoever why Level 3 would pay Verizon **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** for a circuit to a building in New York, NY when it could buy the identical circuit from a CLEC for **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** As discussed above, Level 3 had no legitimate choice but to enter into the lock-up arrangement given that Verizon is the only provider in many locations within its territory, and would charge Level 3 dramatically more in those locations absent the lock-up commitment.

Level 3 provides similar pricing detail in 18 other markets from across the nation in Exhibit A. In each such market, the above scenario is repeated, for the same anti-competitive reason.

In addition to the above, as a general matter, in contrast to the pricing practices of the price cap LECs, CLEC prices do not increase at the expiration of a committed service term if Level 3 wants to continue to use the circuit on a month-to-month basis. In other words, once a term commitment made to a CLEC expires, prices do not increase, and in fact, often *decrease* if the circuits are put back into a new term commitment at the option of the relevant customer. By way of example, say Level 3 were buying a DS-3 from a CLEC for $400 a month under a one year term. At the end of the one year term, Level 3 typically could continue to buy that same DS-3 for $400 on a month-to-month basis, but,

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it might also have the option of getting a 10% discount if it "re-upped" the circuit for another 1 year term. If it chose to do so, it could re-obligate itself to buy the DS-3 from the CLEC for a new 12 month term, but would pay only $360/month for the circuit during the renewal term.

Conversely, if special access services with AT&T, Verizon or CenturyLink are allowed to go month-to-month (or if applicable lock-up plans expire and are not renewed) all discounts associated with those lock up plans and/or term commitments are immediately lost. The corresponding price increases are dramatic. By way of example, the record in this proceeding reflects that discounts for special access circuits under the various price-cap LEC lock-up plans range from 7% to 68%,[10] meaning if those plans were allowed to lapse and the discounts were eliminated, the result would be a price *increase* of between 28% and 213%. Using real numbers, if a circuit had a list price of $2,000 a month, but a customer received a 50% discount for having the circuit in a lock-up plan, the circuit would cost $1,000 a month. If the lock-up plan expired and the discount were lost, however, the price the customer pays for the circuit would double—and increase to $2,000/month. While the price-cap LECs argue that customers have the ability to allow circuits to go month-to-month after a term commitment expires, the foregoing shows that while that might be legally true, it is not true practically, as no customer can realistically swallow a 100% cost increase.

If the already substantially higher price-cap LEC rates (evidenced in the charts above and in Exhibit A Part 4) were increased by 28-213%, while the CLEC rates stayed the same, the already glaring rate discrepancy would be made *dramatically* worse. This is why, as described on pages 8-9 below, Level 3 spends countless hours on a monthly basis making sure price-cap LEC circuits seldom, if ever, come out of term. The following are actual examples of month-to-month rate discrepancies associated with the service examples described above:

Month-to-Month Term Rates[11]

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10 *See* NRRI Report *at* iv (discounts range from 33% to 68%), 21 n.83 (discounts under a typical AT&T Term Pricing Plan with 5-year term receives a 53% discount off the monthly channel termination rate and slightly smaller discounts for dedicated transport, citing AT&T SBC Tariff No. 73 §§ 7.3.10(F)(1), 7.3.10(F)(10.4)(1)), 62 (table shows price-cap LEC discounts from rack rates ranging from 33-68% for channel terminations and from 7% to 68% for dedicated transport); Qwest FCC Tariff No. 1, § 7.1.3.B.2.c (Discount for Qwest Regional Commitment Program is 22%).

11 In most instances, the competitive provider rate does not increase after the term expires, and therefore MTM rates are not reflected for those providers in Exhibit A Part 4.

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Location—Single On-Net Customer Premise	Carrier	Price
Dearborn, MI	AT&T DS1	**[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**
	AT&T DS3	**[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**
	Competitive Provider DS1	**[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**
	Competitive Provider DS3	**[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**
Denver, CO	CenturyLink DS1	**[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**
	CenturyLink DS3	**[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**
	Competitive Provider DS1	**[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**
	Competitive Provider DS3	**[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**

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New York, NY	Verizon DS1	**[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**
	Verizon DS3	**[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**
	Competitive Provider DS1	**[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**
	Competitive Provider DS3	**[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**

If a market were competitive, one would not expect a class of providers (such as the price-cap LECs) to be able to uniformly charge rates well in excess of another class of providers (like CLECs) for identical services to identical locations and maintain a dominant market share over a long period of time. There is no effective competition in the special access market, however, and thus the results shown above prevail. The lack of competition is also evidence of the price-cap LECs' dominance in the marketplace. Simply put, they have the ability to charge excessive rates and earn supra-competitive rates of return without any fear of losing business. They charge what they want, and still maintain the dominant market share percentages discussed in part II of this letter below.

Tw telecom ("twtc") recently filed an ex parte in which it disclosed to the Commission the pricing it sees in the special access market.[12] While Level 3 has been unable to review that data given confidentiality restrictions, Level 3 believes that the pricing data twtc submitted for special access from the price-cap LECs, as compared to that of competitive providers, is likely to be consistent with the Level 3 data discussed above, and as reflected in Exhibit A.

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12 Letter from Thomas Jones, Counsel for tw telecom inc., to Ms. Marlene H. Dortch, Secretary, Federal Communications Commission, WC Docket No. 05-25, RM 10593 (filed Feb. 27, 2012).

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Finally, economists retained by Sprint concluded in March of 2011 that the price-cap LECs have, for sustained periods of time, earned excess rates of return on special access:

> . . . over the last ten years, a variety of studies have concluded that special access services produce excess rates of return as high as 77.9%. By contrast, the Commission's last authorized rate of return was 11.25%.[13]

These findings by Sprint's economists are quite consistent with what Level 3 sees in its business on a daily basis from a pricing perspective.

Differential Term Commitments

The Commission staff expressed an interest in the term commitment obligations to which Level 3 is subject for price-cap LEC services as compared to those to which it is subject to from competitive providers.

Exhibit A, Part 1, shows Level 3's general purchasing patterns for special access service from two competitive carriers, **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**. The vast majority of Level 3's special access purchases from these carriers are made on **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** term commitments. Further, when the applicable term commitments expire, the service terms are allowed to continue on a month-to-month basis without any price consequence (i.e. prices do not increase). Level 3 does sometimes choose to "re-up" circuits purchased from competitive providers, which generally results in a price reduction (as discussed above at page 6).

Conversely, Exhibit A, Part 2 shows examples of the documentation Level 3 monitors[14] for each of AT&T, Verizon and CenturyLink to keep track of the expiration of either i) individual circuit terms (where relevant) and/or ii) price-cap LEC lock-up plans. This level of effort to track the expiration of term or plan commitments is necessary because of the egregious pricing consequences to Level 3 of allowing a circuit to come out of term (as discussed on page 6 above). Accordingly, Level 3 monitors every price-cap LEC circuit that it leases to ensure that circuits come out of term as infrequently as possible, and immediately places expiring circuits back into lengthy term commitments as necessary to avoid the large price increases that would occur if it did not do so. The

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13 Letter from Sprint CEO Daniel Hesse to the Honorable Julius Genachowski, Chairman, WC Docket No. 05-25, RM-10593 (filed Mar. 15, 2011).

14 Level 3 has had to create home grown IT systems to track term obligations to price-cap LECs.

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documentation shown in Exhibit A, Part 2 also demonstrates that the vast majority of special access circuits Level 3 orders with the price-cap LECs are ordered for much longer terms than with CLECs—generally 4 years with Qwest, 5 or more years with AT&T and 7 years with Verizon.

Summarizing the above, the vast majority of the circuit term obligations Level 3 has with CLECs: 1) are month-to-month (because the services have run their term and are continued on a month-to-month basis without a price consequence); or 2) are shorter in duration (considerably so in many cases) than with the price-cap LECs, and entered into voluntarily. In addition, the obligations that Level 3 has with CLECs are not based on prior purchase volumes. Conversely, Level 3's term commitments to the price-cap LECs are generally considerably longer, and are extracted initially and thereafter perpetuated on the basis of prior purchase volumes and largely as the result of: 1) the lack of any meaningful alternative service provider to the price-cap LECs in many places and 2) the outrageous price increases that result if circuits are not kept in long term and/or lock-up plan commitments.

As is true respecting pricing, in a competitive market, it would be unexpected for one class of carriers (*e.g.*, price-cap LECs) to be able to extract and perpetuate long term commitments from their customers based on prior purchase volumes, while another class of carriers (*e.g.*, CLECs) are unable, for competitive reasons, to impose similar commitments on their customers. But again, because of the lack of any meaningful competition in many locations, the price-cap LECs can extract the commitments they want, and still maintain dominant market share percentages discussed in part II of this letter below.

Unilateral Conduct

The Commission staff expressed an interest in evidence of unilateral conduct by the price-cap LECs in commercial dealings. Level 3 specifically discussed with the Commission staff situations in which price-cap LECs unilaterally eliminated service level guarantees and pricing plans providing greater commitment flexibility in favor of more onerous and less flexible plans. Obviously, if a market was competitive, unilateral conduct on the part of service providers that is clearly disadvantageous to customers would be uncommon, if not completely absent.

The price-cap LECs engage in such unilateral conduct routinely. For example, as recently as last month, Verizon unilaterally proposed to raise its special access rates on DS-1 services subject to FCC granted Pricing Flexibility by approximately 8%, something it has done two times in the last year. While it withdrew its latest effort in the face of widespread opposition, the point is that it tried (again) to unilaterally raise its

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special access pricing. Level 3 cannot recall ever experiencing an across the board price increase for special access services by a CLEC.

In addition, in late 2010, because Verizon had failed to meet certain delivery intervals stated in its tariffs[15] for an extended period of time, Verizon unilaterally "suspended" these delivery intervals, which it did **[BEGIN HIGHLY CONFIDENTIAL]** [redacted][16] **[END HIGHLY CONFIDENTIAL]** Verizon completely eliminated the plan under which the delivery intervals were provided, replacing them instead with a "Basic SLA Plan" with far less aggressive delivery intervals and lesser consequences for missing them. Verizon was able to engage in this behavior because it knew that customers like Level 3 would have little choice but to continue to purchase from Verizon under the new plan.

AT&T also made the unilateral move to eliminate its generally available tariffs providing overarching discounts and not requiring individual negotiation. It did so by systematically abolishing, among others, its Managed Value Plan and its BellSouth Transport Advantage Plan.[17] The elimination of these overarching discount plans has forced all AT&T customers seeking discounts into individual plan negotiations that AT&T may then: 1) customize to ensure maximum commitment terms and 2) gerrymander so that only those customers AT&T wants to allow into a given individual plan can avail themselves of it.

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15 *See* Verizon FCC Tariff 1, Section 5.2.1; FCC Tariff 11, Section 5.2.1 and FCC Tariff 14, Section 3.2.1.

16 **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**

17 *E.g.*, Pacific Bell Commission Tariff No. 1, § 22.1 (providing that MVP discount plan is not available to new customers and existing customers may renew pursuant to § 22.3), § 22.3(F) (limiting customer to one renewal); BellSouth Commission Tariff No. 1, § 2.4.8(H) (providing that "effective November 15, 2007, the BellSouth Transport Advantage Plan (TAP) will no longer be available for new customer subscriptions. Customers with an existing TAP may keep the TAP under the terms and conditions specified herein until the term of the TAP expires."). In addition, although AT&T committed as a condition to the BellSouth merger not to raise prices before July 1, 2010, on June 2, 2007, it filed a tariff pre-announcing price increases as of that date more than 3 years in advance, (*see* Exhibit 3 to Declaration of Susan M Gately, Appendix 2 to Comments of the AdHoc Telecommunications Users Committee, WC Docket No. 02-25 (Aug. 8, 2007).

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On July 1, 2010, Qwest unilaterally raised its lock-up commitment level in its FCC Tariff No. 1 from 90% of a customer's channel terminations to 95% of all revenue spent under the plan.[18] Thus, to get the same 22% discount as received previously for "locking up" 90% of a customer's channel terminations (an already onerous amount) the same customer must now, based on an arbitrary and completely unilateral decision by Qwest, "lock-up" 95% of its spend with Qwest under the plan. In addition to the obvious increase of the lock-up percentage (from 90% to 95%), this change by Qwest had the hidden, additional consequence of locking in all "non-channel termination revenue" (like variable mileage) in addition to locking up channel terminations themselves. Thus, where customers previously had flexibility on non-channel termination service elements, they are now locked up on those too, at the 95% level.

These are only examples of the sorts of unilateral conduct engaged in by price-cap LECs—conduct that would certainly not take place if this were a competitive market. Because the market is not competitive, the price-cap LECs can engage in unilateral and anticompetitive conduct as they see fit, and still maintain the dominant market share percentages discussed in part II of this letter below.

As discussed in greater detail below, the fact that the price-cap LECs can charge markedly more (in many cases double or triple) for the same services to the same locations as their competitors can charge is clear evidence of the price-cap LECs' market power. The fact that the price-cap LECs can extract term commitments that are not only longer but also much more ubiquitously applied as compared to their CLEC competitors (where competition is present) is further evidence of their dominance. The unilateral conduct in which the price-cap LECs engage, to the clear detriment of their customers, only reinforces the point.

In a competitive market, in the face of these sorts of anti-competitive activities, customers would simply turn to competitive providers. Because the price-cap LECs' lock-up practices prevent the special access market from becoming competitive, except at a minority of locations, and prevent customers from defecting even if it were, customers lack the ability to make those kinds of choices, and the price-cap LECs are therefore not restricted in their ability to engage in the kinds of behaviors evidenced above.

II. There is Clear Evidence of Market Power in this Proceeding

During Level 3's February 28, 2012 meeting, the Commission asked whether it must make a finding of market power before it can make a determination that the lock-up

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[18] Qwest Commission Tariff No. 1, §§ 7.1.3.B.3.a

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arrangements used by the price-cap LECs violate Section 201(b) of the Act.[19] Level 3 does not believe that a finding of market power is a precondition to a finding of violation of Section 201(b). In fact, there are many examples of action by the Commission to declare tariff provisions or practices unlawful under Section 201(b) without any finding that the unlawful provisions or practices were being employed by a carrier with market power.[20] Consistent with that view, the Commission observed during Level 3's February 28, 2012 meeting that while a finding of market power is not required or dispositive, a finding of market power would "inform the Commission's decision" on whether lock-up practices employed by the price-cap LECs are unjust and unreasonable under Section 201(b). Level 3 agrees with that view. Clearly, under Section 201(b), an entity with a monopolistic share of the market should not be permitted to perpetuate that monopoly through contracting arrangements that significantly restrict competition.

Commission precedent further demonstrates that "firms lacking market power simply cannot rationally price their services in ways which, or impose terms and conditions which, contravene Sections 201(b) and 202(a) of the Act."[21] Said differently, it would be difficult in a competitive market for competitors to engage in "unjust and unreasonable" behavior, as customers would simply turn to competitors instead of agreeing to onerous terms and conditions. The converse is equally true—it is easy for providers to engage in unjust and unreasonable behavior where they face no real competitive threat. Here: 1) special access purchasers are subjected to price-cap LEC lock-up arrangements; 2) are largely unable to turn to alternative competitive providers (even though they would like to); and 3) the price-cap LECs are able to charge supracompetitive rates for special access services, can extract onerous terms and

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19 47 U.S.C § 201(b).

20 *See e.g. AT&T Corp., Complainant, v. YMAX Corp., Defendant,* Memorandum Opinion and Order, 26 FCC Rcd 5742 (2011); *Curt Himmelman, Petitioner, v. MCI Communications Corporation, Respondent; Young Soon Oh and Bernice Schatz, Petitioners, v. AT&T Corporation, Respondent*, Declaratory Order, 17 FCC Rcd 5504 (2002); *Bell Atlantic-Maryland, Inc.; Bell Atlantic-New Jersey, Inc; Bell Atlantic-Pennsylvania, Inc.; Bell Atlantic-Virginia, Inc.; Bell Atlantic Washington DC, Inc.; Bell Atlantic-West Virginia, Inc.; New York Telephone Co.; and New England Telephone and Telegraph Co., Complainants, v. Global Naps, Inc., Defendant*, Memorandum Opinion and Order, 15 FCC Rcd 20665 (2000); *Rainbow Programming Holdings, Inc., Complainant, v. Bell Atlantic-New Jersey, Inc., and Bell Atlantic Network Services, Inc., Defendants*, Memorandum Opinion and Order, 15 FCC Rcd 11754 (2000).

21 *In the Matter of Policy and Rules Concerning the Interstate, Interexchange Marketplace*, Notice of Proposed Rulemaking, CC Docket No. 96-61, 11 FCC Rcd 7141 (1996) at ¶ 28.

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conditions, and can engage in clearly anticompetitive unilateral conduct without any real fear of significant customer defection. All of this demonstrates quite plainly that the price-cap LECs do possess market power in the special access market.[22] To this end, Level 3 offers the following evidence of the price-cap LECs' market power, which should inform the Commission's finding that the price-cap LEC lock-up practices are unjust and unreasonable and therefore unlawful under Section 201(b) of the Act. The evidence of market power is as overwhelming as it is longstanding.

A. Evidence of Market Power

Market power analysis generally starts by defining the relevant market, both from a product perspective and a geographic perspective. From a product perspective, a special access circuit is generally synonymous with a local private line—a private line that connects a carrier's network to a customer premises like a cell site or an enterprise building.[23] With respect to special access circuits that are not the subject of forbearance, the product market is further divided into two sub-markets, DS-1s and DS-3s, based on capacity. A DS-3 is equal to 28 DS-1s. A customer seeking a DS-1 could use a DS-3, but such a purchase would not be economical as it would be more expensive, and 28 times bigger than the customer requires. Likewise, a customer seeking a DS-3 could

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22 In the *Competitive Carrier First Report and Order*, the Commission held that "The economic underpinning of our proposal to streamline the regulatory procedures for nondominant carriers flows from the fact that firms lacking market power simply cannot rationally price their services in ways which, or impose terms and conditions which, contravene Sections 201(b) and 202(a) of the Act." *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor*, CC Docket No. 79-252, First Report and Order, 85 FCC 2d 1 (1980) at ¶ 31.

23 While not directly relevant to these discussions, local private lines are a distinct market from local dedicated interoffice circuits, or circuits which connect two price-cap LEC switches to one and other. In an antitrust analysis, dedicated interoffice switches would be a distinct product market from local private lines, because neither can be used as a substitute for the other. This distinction is relevant because: 1) there is more competition in the local dedicated interoffice circuit market than in the local private line market, and 2) the price-cap LECs use their dominance in the former to gain leverage in that later. Evaluation of these issues is not particularly relevant to the limited market power discussion in this letter, so we do not address them further herein.

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instead purchase 28 DS-1s, but such a purchase would also be uneconomical, as a DS-3 would cost significantly less than 28 DS-1s.[24]

Respecting the geographic market, the Department of Justice concluded in the context of a merger analysis that the geographic market for special access circuits is the specific connection to a particular building.[25] This makes sense, as a customer would not ordinarily have the realistic option of moving from one building to another building in order to obtain a lower price on local private lines, as the cost of moving would exceed the savings on local private lines. Similarly, the Commission stated in ¶ 152 of its *Triennial Review Remand Order* ("*TRRO*"), that "a loop serves a specific location and cannot economically be transferred to serve another location."[26] More broadly, it may also be argued that the geographic market is the territory served by a price cap LEC, as the tariffs and contracts pursuant to which the price cap LECs sell most of their special access circuits are region-wide.

Using these definitions of the applicable market, market power—and in this case, monopoly power—can be shown by direct or circumstantial evidence, both of which are prevalent in this docket. As discussed below, the price-cap LECs' share of the relevant market is, under most methods of analysis, 90% or higher in each price-cap LEC's home territory, levels that establish a presumption that each price-cap LEC possesses monopoly power. This presumption is reinforced by durability of monopoly market shares over long periods of time, the existence of barriers to entry,[27] burdensome terms and conditions leading to longstanding customer dissatisfaction, independent government and private studies finding monopoly power, and clear evidence of longstanding supracompetitive pricing.

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24 *See* (Mitchell-Woodbury Declaration) at ¶¶ 16-28; Unbundled Access to Network Elements, *Order on Remand*, 20 Commission Rcd 2533 at 2625, 2627-28 ¶¶ 166, 170-71 (2005) ("*TRRO*").

25 *See* United States' Notice of Public Filing of Redacted Submission, Redacted Declaration of W. Robert Majeure at 11 n.17, *United States v. SBC Comm's, Inc.*, Case No. 1:05-cv-02102, D.E/. 133 (D.D.C. Aug. 9, 2006). The DoJ required divestiture of one of the two circuits where the merging parties owned the only two circuits to the building and competitive entry was unlikely.

26 Order on Remand, 20 FCC Rcd 2533, WC Docket No. 04-313, CC Docket No. 01-338 (February 4, 2005) ("*TRRO*").

27 Barriers to entry are not addressed further in this letter, but are addressed in Level 3's February 22, 2012 ex parte beginning at page 25.

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Although courts have not yet identified a precise level at which monopoly power will be inferred,[28] a 75% share is generally considered sufficient to raise a presumption of monopoly.[29] Some sources place the threshold at 66%[30] or lower. Some cases require a much smaller than monopoly market share (in the 30-50% range) in order to find a contractually imposed market foreclosure violating the antitrust laws.[31] The lock-up

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28 SECTION OF ANTITRUST LAW, AM. BAR ASS'N, MARKET POWER HANDBOOK 19–20 (2005) (footnote omitted).

29 *See, e.g., U.S. v. Dentsply Int'l, Inc.*, 399 F.3d 181, 187-188 (3d Cir. 2005) ("[A] persistently high market share between 75% and 80% on a revenue basis" is "more than adequate to establish a prima facie case of power"); *U.S. v. Microsoft Corp.*, 253 F.3d 34, 51-53 (D.C. Cir. 2001) ("Monopoly power may be inferred from a firm's possession of a dominant share of a relevant market that is protected by entry barriers" and was present where Microsoft possessed a share of computer operating systems that was either 80% or 95%, depending upon whether one did or did not count Apple computers (in the 1990s) as part of the market); see *also Microsoft*, 253 F.3d at 54 (citing *U.S. v. Grinnell Corp.*, 384 U.S. 563, 571 (1966) (87% is presumed dominant); *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 481 (1992) (80%); *U.S. v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 391 (1956) (75%).

30 In its 2008 Single-Firm Conduct Report, DOJ concluded that "[i]f a firm has maintained a market share in excess of two-thirds for a significant period and the firm's market share is unlikely to be eroded in the near future, the Department [of Justice] believes that such facts ordinarily should establish a rebuttable presumption that the firm possesses monopoly power." U.S. DEP'T OF JUSTICE, COMPETITION AND MONOPOLY: SINGLE FIRM CONDUCT UNDER SECTION 2 OF THE SHERMAN ACT (2008), at p. 30 (collecting cases and commentary showing that this is a consensus view). This Report was withdrawn in May 2009 but this particular conclusion was not rejected. In fact, DOJ leadership stated that the reason for the withdrawal was that the Report was not sufficiently aggressive toward monopolists, and that DOJ believed it needed more flexibility to allege monopoly conduct – leadership statements suggesting that current DOJ practice may support a presumption of monopoly at a level even lower than 66%.

31 *U.S. v. Microsoft Corp.*, 253 F.3d 34, 70 (D.C. Cir. 2001) (violation "even though the contracts foreclose less than the roughly 40% or 50% share usually required in order to establish a § 1 violation"); *Natchitoches Parish Hosp. Serv. Dist. v. Tyco Int'l, Ltd.*, 2009 U.S. Dist LEXIS 108858; 2009-2 Trade Cas. (CCH) ¶ 76,815 (foreclosure of 32-39% of market was sufficient); *E.I. Du Pont de Nemours and Co. v. Kolon Industries, Inc.*, 683 F.Supp. 2d 401 (E.D. Va. 2009) (court observed that if it had adopted plaintiff's market definition, foreclosure would have been 43%, which would have been sufficient to support an antitrust violation); *Tele Atlas N.V. v. NAVTEQ Corp.*, 2008 WL 4809441 (N.D. Cal.) (denial of defendant's summary judgment motion; contracts lasting multiple

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arrangements alleged by Level 3 to be unjust and unreasonable are contractually imposed market foreclosure mechanisms, which would argue for application of the much lower (30-50%) market share percentages noted. In any event, the price-cap LECs' share far exceeds the threshold, whichever one is chosen. They are not merely dominant, as might be argued for a firm at the lower side of the threshold, but super-dominant, with under most analyses 90%-plus market shares that have remained stable over long periods of time. This is true whether measured by buildings served, Herfindahl-Hirschman Index concentration measurements, or other indicia of market share.

The evidence in this docket of the price-cap LECs monopolistic market shares of the special access market is summarized below:

In 1999, the Commission deregulated parts of the special access market through its Pricing Flexibility Order.[32] It did not take long before things were noted to be amiss, and in 2002, before it was acquired by a price-cap LEC and changed its view, AT&T filed a petition requesting that the Commission re-regulate these markets.[33] AT&T claimed, among other things, that the pricing flexibility triggers established by the Commission when deregulating parts of the special access market failed to predict price-constraining competitive entry and, rather, that significant competitive entry has not occurred.[34]

In 2003, the Commission itself observed that only "between 3% and 5% of the nation's commercial office buildings are served by competitor-owned fiber loops."[35]

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years could be viewed by a jury as exclusive dealing contracts where there were "outs" that were difficult to invoke and buyers treated them as exclusive; contract foreclosing over 35% of market "warrant[ed] heighted scrutiny" because it involved "a concentrated product market with high sunk costs, zero marginal costs, and high switching costs").

32 *Access Charge Reform*, CC Docket No. 96-262, Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 Commission Rcd 14221 (1999) (*Pricing Flexibility Order*), aff'd, *WorldCom, Inc. v. Commission*, 238 F.3d 449 (D.C. Cir. 2001). Price-cap incumbents must file a petition seeking pricing flexibility. 47 C.F.R. § 1.774.

33 AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services, RM-10593 (October 15, 2002) (AT&T Petition"). AT&T has switched positions since its corporate parent combined with SBC into the new AT&T Inc., as discussed further below.

34 AT&T Petition at 2, 6-7, 11-13, 20, 25-32.

35 *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket No. 01-338, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, 18 Commission Rcd. 16978, 17155, n.856 (2003).

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Said differently, in 2003 the Commission concluded that between 95% and 97% of the nation's commercial office buildings were serviced by only one provider of fiber loops.

In 2004, two Commission economists published an article reviewing the trends in special access tariffs during the first four years of pricing flexibility.[36] Uri and Zimmerman reviewed tariffed rates filed at the Commission and carrier earnings reported to the Commission through the ARMIS system. They concluded that price-cap LECs have market power in supplying special access service and had taken advantage of that power.[37]

In 2005 (in the price-cap LEC merger cases) the United States Department of Justice concluded that for the vast majority of commercial buildings in their territories, SBC (now AT&T) and Verizon were each the only carrier that owned a last-mile connection to the building.[38] Also in 2005 Nextel, a major wireless company and a large buyer of special access services, informed the Commission that it obtained only about 4% of its DS1s from non-price-cap LEC suppliers. Nextel also noted that T-Mobile had similarly reported in 2005 that it depended on ILECs for over 96% of local private lines, and referenced a 2004 declaration submitted by AT&T stating that AT&T obtained 93% of its DS1-level transport from incumbent carriers.[39] Nextel further reported that when it issued a Request for Information for the provision of high capacity circuits to its 1,500 cell sites in the New York City metropolitan area, it received offers from CLECs for only 43, or less than 3%.[40]

In 2006, the United States Government Accountability Office ("GAO") issued its Report to the Chairman, Committee on Government Reform, House of Representatives styled "*Commission Needs to Improve Its Ability to Monitor and Determine the Extent of Competition in Dedicated Access Services*."[41] In it, the GAO found the following:

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36 Uri and Zimmerman, Market Power and the Deregulation of Special Access Service by the Federal Communications Commission, 13 Information & Telecommunications Technology Law No. 2 at 129 (2004).

37 *Id.* at 135, 170.

38 PRICE-CAP LEC Merger Complaints, ¶ 15, 20.

39 Declaration of Bridger M. Mitchell and John R. Woodbury, Attachment 1 to Reply Comments of Nextel Communications, Inc., WC Docket No. 05-25 (July 29, 2005) ("Mitchell-Woodbury Declaration"), at p. 24 ¶ 61.

40 Mitchell-Woodbury Declaration at p. 24, ¶ 62.

41 *See e.g.*, United States Government Accountability Office, Report to the Chairman, Committee on Government Reform, House of Representatives,

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- In the 16 major metropolitan areas examined, facilities-based competition for dedicated access services exists in a relatively small subset of buildings.[42]

- The analysis of data on the presence of competitors in commercial buildings suggests that competitors are serving, on average, less than 6 percent of the buildings with at least a DS-1 level of demand (94% non-competitive).[43]

- For the subset of buildings identified as likely having companies with a DS-3 level of demand, competitors have a fiber-based presence in about 15 percent of buildings on average (85% non-competitive).[44]

- For buildings identified with 2 DS-3s of demand, competitors have a fiber-based presence in 24 percent of buildings on average (76% non-competitive).[45]

- Data analysis from the four major price-cap incumbent firms and the Commission, which was intended to determine how prices have changed since the granting of phase II pricing flexibility, generally showed that prices and average revenues are higher, on average, in phase II MSAs—where competition is theoretically more vigorous—than in phase I MSAs or in areas where prices are still constrained by the price cap.[46]

- Facilities-based competition for dedicated access services to end users at the building level (i.e., analogous to channel terminations to end users) does not appear to be extensive in the MSAs examined, although

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Telecommunications: FCC Needs to Improve its Ability to Monitor and Determine the Extent of Competition in Dedicated Access Services, GAO-07-80 (2006), *available at* http://www.gao.gov/new.items/d0780.pdf ("GAO Report").

42 GAO Report at 12.

43 *Id*.

44 *Id.*

45 *Id.*

46 GAO Report at 13.

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moderate[47] levels of competition appear where demand for dedicated access exceeds the DS-3 level.[48]

- According to data from July 2006, facilities-based competitors have extended their networks to a relatively small subset of buildings in the MSAs examined.[49]

- Since the Commission first began granting pricing flexibility in 2001, GAO's comparison of prices and revenue across phase I flexibility and phase II flexibility suggests that list prices and revenue are higher on average for circuit components in areas under phase II flexibility (areas where competitive forces are presumed to be greatest) than in areas under phase I flexibility or under price caps.[50]

Recalling that monopolistic market power is generally inferred at the 75% market share level (if not much lower in this context since lock-up arrangements are contractually imposed market foreclosure mechanisms)—in the markets examined, the GAO concluded in 2006 that there was no competition in 76% of buildings with more than a DS-3s demand, no competition in 85% of buildings with a DS-3s demand, no competition in 94% of buildings with a DS-1s demand, facilities based carriers were not building competitive facilities to many buildings, and special access prices were actually *higher* in markets where prices were no longer regulated.[51]

In 2007, Dr. Bridger Mitchell, an expert in competition and pricing in the telecommunications industry retained by Sprint, observed that "the median percentage of total DS-1 channel terminations circuits purchased from incumbent LECs was 99%, and for DS-1 transport 98%. For DS-3 channel terminations, the median was 91%, but for DS-3 transport 67%.

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47 "Moderate" here means competition in 15% of buildings with a DS-3 of demand, and 24% of buildings with 2 DS-3s of demand, meaning *none* in the remaining 85% and 76%, respectively. Even in these areas of "moderate" competition, monopolistic market power is present. GAO Report at 20.

48 GAO Report at 19.

49 *Id.*

50 *Id* at 27.

51 GAO Report at 2.

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In 2008, the National Regulatory Research Institute ("NRRI") agreed to assist with a project to examine competitive issues in special access in selected markets. The NRRI issued its report, in 2009, styled "*Competitive Issues in Special Access Markets*."[52] The NRRI found the following:

- ILECs still have strong market power in most geographic areas, particularly for channel terminations and DS-1 services.[53]

- [Market] [c]oncentrations are particularly high for all channel terminations and for DS-1 services . . . even after adjustment for separation problems, RBOC earnings on special access are well above the 11.25% rate most recently set by the Commission.[54] In the case of AT&T and Qwest, earnings are about three times that rate.[55]

- Almost ten years have passed since the *Pricing Flexibility Order,* but in no city examined was there evidence of anything approaching ubiquitous overbuilding of channel terminations by landline carriers. Even in highly concentrated business areas, fiber overbuilds pass only some customer locations. High entry and exit costs limit these facilities-based carriers from extending their networks to any but the largest or most conveniently served customers.[56]

- Today, facilities-based competition seems far from inevitable. It is hard to imagine a plausible scenario in which new entrants will begin building DS-1 channel terminations out to their special access customers in the far corners of urban areas. The Commission erred in predicting an end to CLEC reliance on ILEC channel terminations. The CLEC dependency turned out not to be for an initial period at all, but for an indefinite period.[57]

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52 *See* Peter Bluhm with Dr. Robert Loube, National Regulatory Research Institute, *Competitive Issues in Special Access Markets – Revised Edition,* No. 09-02 (First Issued Jan. 21, 2009), *available at* http://nrri.org/pubs/telecommunications/NRRI_spcl_access_mkts_jan09-02.pdf ("NRRI Report").

53 *Id* at 79.

54 *Id* at 79-80.

55 NRRI Report at 80.

56 *Id.* at 83.

57 NRRI Report at 83.

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In reaching its conclusions, the NRRI examined market concentration using two different metrics, HHI analysis and ILEC market share analysis.[58] The NRRI's findings definitively show that the special access market is highly concentrated, and that the price-cap LECs have market power. For instance:

- The national average HHI values[59] for channel terminations were summarized as follows. These results show a continuing high concentration for channel termination services. None of the markets have as many as two effective firms, and the data places all special access markets far into the zone characterized by the Merger Guidelines as highly concentrated.[60]

All MSAs	Median HHI			Number of Effective Firms		
	2001	2006	2007	2001	2006	2007
DS-1 Channel Terminations	8,560	8,512	8,464	1.17	1.17	1.18
DS-3 Channel Terminations	6,897	7,124	7,717	1.45	1.40	1.30

- The detailed ILEC market share results for channel termination by city were summarized as follows. Once again, the results show a continuing very high concentration for all services.[61]

Median MSA percent of total circuits purchased from ILECs	2001	2006	2007
DS-1 Channel Terminations	92%	100%	99%
DS-3 Channel Terminations	81%	92%	91%

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58 *See id.* at 45.

59 The Herfindahl-Hirschman Index ("HHI") is a measure of the concentration within a market, defined as the sum of the squares of the market shares of each firm in the market. HHI can range from 10,000 in the case of a monopoly to a number approaching zero. Another way of understanding HHI results is to translate the HHI value for a market into a number of effective firms in that market. The number of effective firms is calculated by dividing the HHI into 10,000. NRRI Report at 38-39.

60 NRRI Report at 41.

61 *Id.* at 42.

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- The following table shows the percent of cities where NRRI determined that the ILEC had at least an 80% market share in 2007 for channel terminations. The table shows that ILECs maintain a strongly dominant share of DS-1 business in virtually all cities, and DS-3 channel terminations remain strongly concentrated with ILECs in about two-thirds of the cities having an 80% market share or better.[62]

Percentage of 50 MSAs where ILECs have at least an 80% market share	**2006**	**2007**
DS-1 Channel Terminations	100%	96%
DS-3 Channel Terminations	62%	68%

- Summarizing, the NRRI found that:

  1. ILECs maintain strongly dominant market shares for DS-1 channel terminations. Nationally in 2007, this market had 1.18 effective firms, and ILECs provided 99 out of every 100 units of this service. ILECs have at least an 80% market share in every MSA studied except Oklahoma City and Sacramento.[63]

  2. ILECs maintain dominant market shares for DS-3 channel terminations. Nationally in 2007, this market had 1.30 effective firms, and ILECs provided 91 out of every 100 units of this service. The data show that concentration is increasing, and the HHI for DS-3 channel terminations reached its highest level in 2007. ILECs have at least an 80% market share in 68% of the MSAs the NRRI studied.[64]

Fast forward to today, and Level 3 continues to purchase in excess of [**BEGIN HIGHLY CONFIDENTIAL**] [redacted] [**END HIGHLY CONFIDENTIAL**] of its DS1 special access service needs from the price-cap LECs, and as noted above, Sprint has told the Commission as recently as April 24, 2012 that it continues to purchase approximately 90% of its existing TDM DS-1s from incumbent providers.[65] Thirteen years following

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62 *Id.*

63 NRRI Report at 45.

64 NRRI Report at 46.

65 *Supra*, at note 1.

deregulation of the special access market, the price-cap LECs continue to have a super-dominant stranglehold on the market, in large measure because their lock-up practices have been effective in eliminating any real possibility of the market becoming competitive.

B. Pricing, Burdensome Terms and Customer Dissatisfaction

The price-cap LECs' high market shares cannot be attributed to superior pricing. As shown in part I of this letter above and in Exhibit A, the price-cap LECs' prices are dramatically higher than those of their competitors in the limited locations where competitors are able to compete. Further, most of the price-cap LECs' largest customers for special access have submitted filings in this docket expressing extreme dissatisfaction with the prices, terms and conditions offered by the price-cap LECs, including Sprint Nextel Corp., T-Mobile, US Cellular, Ad Hoc Telecommunications Users Group, BT Americas, Inc., Global Crossing, PAETEC Communications, TelePacific Communications, New Edge Networks, Inc., TDS Metrocom, Integra Telecom, One Communications, tw telecom inc, Cbeyond, Inc., Deltacom, Inc., Clearwire, and XO Communications.

The price-cap LECs' shares also cannot be attributed to superior quality. The special access product is essentially a commodity, and to the extent that quality plays a role in customer decisions, Level 3's experience (both as a CLEC provider and as a CLEC customer) is that CLEC quality matches and more often than not exceeds that of the price-cap LECs. In particular, CLECs often are quicker than price-cap LECs in installing new circuits and in repairing out-of-service circuits. Quality does not explain the price-cap LECs' high market shares.

The imposition of burdensome terms and conditions, discussed at length above and in Level 3's February 22, 2012 ex parte, is further evidence of the price-cap LECs' market power. The exaction of burdensome terms and conditions has been found to be evidence of market power in a wide variety of contexts.[66] Evidence that customers are "dissatisfied" with such terms and conditions, and yet still feel that they cannot switch to a rival—as found in *Dentsply*[67]—helps establish both that monopoly power exists and that an appropriate remedy will be effective to correct the competitive problem and enable customer defections.

C. Supracompetitive Return on Capital

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66 *Antitrust Law Developments* (6th) at p. 191.

67 *U.S. v. Dentsply Int'l, Inc.*, 399 F.3d 181, 185 (3d Cir. 2005).

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Sustained supracompetitive returns on capital are also direct evidence of monopoly power, as reflected by the price-cap LECs' own Automated Reporting and Management Information System (ARMIS) revenue and cost data reported to the Commission. ARMIS data submitted in the record of the Commission proceeding on special access reflects that the price-cap LECs' average rate of return was 43.7% in 2003 and rose to 101% in 2007.[68]

While the price-cap LECs have and will likely argue that ARMIS data overstates their returns, this is self-serving and strong arguments have been made that ARMIS data in fact fairly reflect the return on investment that they earn selling special access.[69] Even the independent NRRI Report, which agreed with the price-cap LECs that ARMIS data should be adjusted, concluded that the adjusted rates of return for 2007 were 38% for Qwest, 30% for AT&T, and 15% for Verizon.[70] NRRI concluded that these adjusted data support "a conclusion that all three large price-cap LECs have raised prices above average cost, defined in the traditional accounting sense. We take such high earnings as evidence that the three price-cap LECs continue to have market power and, that AT&T and Qwest at least, have made substantial and sustained price increases that are based on the use of market power."[71]

Prices that would prevail in a competitive market can also be measured by a number of comparisons, and in each case, the price-cap LECs' special access prices are far higher than the comparison prices. Examples include comparisons with: (1) retail prices charged by CLECs for the same services in those locations where CLECs operate,[72] (2) the price of similar services offered by the price-cap LECs at retail in

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68 Economics and Technology, Inc, "Longstanding Regulatory Tools Confirm BOC Market Power," Attachment B to Comments of the Ad Hoc Telecommunications Users Committee, WC Docket 05-25 (January 19, 2010); *see* Economics and Technology, Inc., "Special Access Overpricing and the US Economy," Appendix 1 to of the Ad Hoc Telecommunications Users Committee, WC Docket 05-25 (August 7, 2007).

69 *Id.*

70 NRRI Report at 70-71.

71 *Id.* at 71. While Level 3 urges the Commission to act on its request without issuing any additional data requests, if it chooses to issue mandatory data requests, it should require the price-cap LECs to provide their documents reflecting the anticipated and/or actual return on their investment of capital in special access circuits that they use in making business decisions.

72 *See* discussion in part I of this letter above and Exhibit A. See also declaration of Janet Fischer, Attachment to Comments of Global Crossing North America Inc., WC Docket 05-25 (August 7, 2007) at 7-9; Reply Declaration of Joseph Farrell, Attachment

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competitive markets,[73] (3) tariffed prices offered by the small rural carrier members of the National Exchange Carrier Association (NECA), which obviously have higher costs than the price-cap LECs,[74] and (4) prices offered for similar services in other countries.[75] In addition, the fact that prices are higher where the price-cap LECs were granted complete pricing flexibility than where they were not granted such flexibility shows that the Commission was mistaken to conclude that competition would constrain prices where it granted flexibility.[76] For instance, a recent petition filed by U.S. TelePacific Communications (see Tables 1 and 2 below), demonstrates the large discrepancy between Verizon's pricing flexibility rates as compared to key benchmarks such price cap rates, NECA rates and UNE rates.[77]

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to Reply Comments of CompTel *et al.*, WC Docket 05-25 (July 29, 2005) ("Farrell Declaration") at 19-20 (BellSouth study showed that its average special access rates were 53-94% higher than rates of competitive carriers); *see* letter of Thomas Jones to Ms. Marlene H. Dortch, WC Docket 05-25 (July 9, 2009) at 2 (price charts filed by Time Warner Telecom "showed that incumbent LECs price at least their DS1 and DS3 services well above competitors").

73 *See* Comments of the NoChokePoints Coalition, WC Docket No. 05-25 (January 19, 2010) ("NoChokePoints Comments") at pp. 23-24 (Sprint paid approximately 11 times as much for a DS-1 circuit as Price-cap LECs sell a similar capacity DSL service and paid approximately 7 times as much as Verizon sells FiOS and AT&T sells U-Verse to retail customers, even though FiOS and U-Verse offer much more capacity than a DS-1).

74 *See* Comments of PAETEC Holdings Inc. *et al.*, WC Docket No. 05-25 (January 19, 2010) at p. 8-9 (PRICE-CAP LEC rates exceed NECA rates by 45-154%).

75 Comments of BT Americas Inc, Docket 05-25 (August 8, 2007) at 16-17 and Attachment A (demonstrating that special access prices in the United States are materially higher than prices for similar services in the United Kingdom).

76 An alternative explanation would be that the prices under non-flex capped pricing were artificially low; however, such an explanation is refuted by the evidence on supracompetitive rate of return.

77 *See* Telepacific Communications Petition to Reject or Suspend and Investigate Propose Tariff Revisions, Transmittal No. 1187 at 9-10 (filed May 7, 2012).

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Table 1			
CALIFORNIA DS-1 CHANNEL TERMINATION RATE COMPARISON			
Pricing Flexibility (Monthly Rate for a 3-Year Term Price Band A (1001-3000 threshold))	**Price Cap** (Monthly Rate for a 3-Year Term Zone 1 (1001-3000 threshold))	**NECA** (Monthly Rate for a 3-Year Term Rate Band 1)	**DS-1 UNE** (Monthly Zone 1 Rate)
$168.20	**$152.36**	**$82.67**	**$67.70**
Current rate: $158.68 (*) Prev. rate: $149.70 (**)	Current rate: $152.36 (*) Prev. rate: $152.36 (**)	Prev. 7/1/10 rate: $89.96 (*) Prev. 7/1/09 rate: $96.30 (**)	
Tariff FCC NO. 14 5-245 (Effective May 15, 2012) (*) Tariff FCC NO. 14 5-245 (Effective July 16, 2011) (**) Tariff FCC NO. 14 5-245 (Effective July 1, 2010)	Tariff FCC NO. 14 5-245 (Effective May 15, 2012) (*)Tariff FCC NO. 14 5-245 (Effective July 16, 2011) (**) Tariff FCC NO. 14 5-245 (Effective July 1, 2010)	NECA Tariff F.C.C. No. 5, 17-27 (Effective July 1, 2011) ($91.86 less 10%) (*) NECA Tariff F.C.C. No. 5, 17-27 (Effective July 1, 2010) ($99.96 less 10% discount) (**) NECA Tariff F.C.C. No. 5, 17-27 (Effective July 1, 2009) ($107.00 less 10 % discount)	R.93-04-003, I.93-04-002

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TABLE 2			
CALIFORNIA DS-1 10-MILE CIRCUIT (CHANNEL TERMINATION, CHANNEL MILEAGE FIXED AND PER MILE RATE ELEMENTS) RATE COMPARISON			
Pricing Flexibility Monthly Rate for a 3-Year Term Price Band A (1001-3000 threshold)	**Price Cap Rates** Monthly Rate for a 3-Year Term Zone 1 (1001-3000 threshold)	**NECA DS-1** Monthly Rate for Rate Band 1	**CA UNE** Monthly Rate
$321.57	**$ 277.70**	**$168.68**	**$78.77**
Current rate: $303.41(*) Prev. rate: $286.20(**)	Current rate: $277.70 (*) Prev. rate: $277.70 (**)	Prev. 7/1/10 rate: $183.59 (*) Prev. 7/1/09 rate: $196.74 (**)	
Tariff FCC NO. 14 5-209 & 5-245 (Effective May 15, 2012) ($168.20 plus $34.27 plus 10 miles of Special Transport at $11.91 per mile) (*) Tariff FCC NO. 14 5-209 & 5-245 (Effective July 16, 2011) ($158.68 plus $32.33 plus 10 miles of Special Transport at $11.24 per mile) (**) Tariff FCC NO. 14 5-209 & 5-245(Effective July 1, 2010) ($149.70 plus $30.50 plus 10 miles of Special Transport at $10.60 per mile)	Tariff FCC NO. 14 5-209 & 5-245 (Effective May 15, 2012) ($152.36 plus $25.34 plus 10 miles of Special Transport at $10.00 per mile) (*) Tariff FCC NO. 14 5-209 & 5-245 (Effective July 16, 2011) (same) (**) Tariff FCC NO. 14 5-209 & 5-245 (Effective July 16, 2011) (same)	NECA Tariff F.C.C. No. 5, 17-26.1 and 17-27 (Effective July 1, 2011) ($91.86 plus $32.66 channel mileage term. plus 10 miles of channel mileage facility at $6.29 per mile) less 10% discount to total) (*) NECA Tariff F.C.C. No. 5, 17-26.1 and 17-27 (Effective July 1, 2010) ($99.96 plus $35.53 channel mileage term. plus 10 miles of channel mileage facility at $6.85 per mile) less 10% discount of total) (**) NECA Tariff F.C.C. No. 5, 17-26.1 and 17-27 (Effective July 1, 2009) (($107.00 plus $38.03 channel mileage term. plus 10 miles of channel mileage facility at $7.33 per mile) less 10% discount of total)	R.93-04-003, I.93-04-002 ($67.70 plus $9.77 plus 10 miles of transport at $.13 per mile)

The comprehensive study of 56 MSAs conducted by the GAO (and referenced above) shows that the Price-cap LECs' rates are actually *higher* where they have complete pricing flexibility.[78] The similar study performed by NRRI noted that its findings were "consistent with the GAO report" and concluded that the evidence suggests "that sellers are using market power" in areas of total pricing flexibility "to raise prices to their large wholesale customers."[79] The independent findings of GAO and NRRI are

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78 GAO Report at pp. 13, 14, 27-30, 32, 63.

79 NRRI report at 66.

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confirmed by substantial record evidence submitted to the Commission by other parties[80] and the evidence submitted by Level 3 in this letter. AT&T's 2002 Petition to the Commission likewise alleged that "[t]he fact that the Bells' rates are consistently higher in the lower cost areas is vivid proof that the Bells retain overwhelming market power in every local market, including those with the most competitive activity."[81]

While the price-cap LECs have argued that their special access prices have declined since they were given price flexibility, this argument is factually wrong[82] and, even if it were not, it is unavailing. As prominent economist Professor Joseph Farrell demonstrated, "even a monopoly will reduce price if marginal costs fall or if demand becomes more elastic. In addition a firm with decreasing, but still very substantial, market power will reduce prices for that reason. . . . [I]t logically is the *relative levels* of price and cost . . . that matter."[83] Professor Farrell is supported in this regard by the

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80 *See* Economics and Technology, Inc., "Special Access Overpricing and the US Economy," Appendix 1 to of the Ad Hoc Telecommunications Users Committee, WC Docket 05-25 (August 7, 2007). At 21, A-22-A-23 (price flex prices higher than price caps in various cities); NuVox, Initial Comments, Docket WC 04-313 (Sept. 30, 2004) at 17 (mileage components of special access subject to pricing flexibility were more than double than under price caps).

81 AT&T Petition at p. 13.

82 *See* Comments of CompTel *et al.*, WC Docket 05-25 at pp. 6-9 (rates in pricing flexibility areas have in fact increased); (Fischer Declaration at 2-6 (special access prices in price flex areas either trended higher or remained flat); Farrell Declaration at pp. 9-14 (Verizon's study based on changes in average revenue per line does not accurately reflect changes in rates). Level 3 has noted significant increases in price cap LEC pricing through elimination of certain discounts, such as AT&T's Managed Value Plan ("MVP") and Transport Advantage Plan ("TAP") discounts. *E.g.*, Pacific Bell Commission Tariff No. 1, § 22.1 (providing that MVP discount plan is not available to new customers and existing customers may renew pursuant to § 22.3), § 22.3(F) (limiting customer to one renewal); BellSouth Commission Tariff No. , § 2.4.8(H) (providing that "effective November 15, 2007, the BellSouth TAP will no longer be available for new customer subscriptions. Customers with an existing TAP may keep the TAP under the terms and conditions specified herein until the term of the TAP expires."). In addition, although AT&T committed as a condition to the BellSouth merger not to raise prices before July 1, 2010, on June 2, 2007, it filed a tariff pre-announcing price increases as of that date more than 3 years in advance, (*see* Exhibit 3 to Declaration of Susan M Gately, Appendix 2 to Comments of the AdHoc Telecommunications Users Committee, WC Docket No. 02-25 (Aug. 8, 2007).

83 Farrell Declaration at 15-18 (emphasis original).

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declaration of economist Stanley M. Besen, which states: "The important point here is that the difference between a competitive and a monopolistic industry is not the direction of, or the rate at which, their respective prices *change* during a given period but the fact that a monopolist charges a *higher* price relative to marginal cost than does a competitive firm."[84]

Not surprisingly, in the $18,000,000,000+ market for special access circuits not subject to forbearance of which Level 3 alleges the price-cap LECs have dominant market positions, the price-cap LECs disagree that they are dominant. Accordingly, they argue that potential rivals (including Level 3) have the technical capacity, experience, capitalization, and reputation necessary to supply a large percentage of special access volume, and that this potential competition constrains the price-cap LECs' behavior and renders the market competitive notwithstanding their current dominance.[85] The price-cap LECs are correct that rivals (including Level 3) have the technical capacity and capitalization to compete for portions of the relevant special access markets. But they are not correct to suggest that rivals currently constrain the price-cap LECs' power in the real world, or have any prospect of doing so in the foreseeable future, so long as the lock-ups remain in place. Like trying to attend a sold out event, competitive rivals have the capability to show up at the venue but no ability to gain entry. The lock-ups keep rivals' competition in a perpetually potential mode—that is the whole point of the lock-ups. This is because the lock-up contracts take advantage of some barriers to entry, and create others.

The record in this proceeding is replete with evidence of market power. This evidence, combined with the analysis of the lock-up practices being employed by these firms as stated in Level 3's February 22, 2012 ex parte and the anti-competitive results stemming from them, provide all the evidence the Commission needs to grant the remedies Level 3 has requested.

III. Conclusion

This docket is replete with evidence of the price-cap LECs' market power in the special access marketplace, market power they had when the market was initially

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84 Declaration of Stanley M. Besen, attachment to letter of Thomas Jones to Marlene H. Dortch, WC Docket No. 05-25 (July 9, 2009) (emphasis original).

85 *E.g.,* Comments of Verizon and Verizon Wireless, WC Docket 05-25 (January 19, 2010) at pp. 19-29; Reply Comments of Verizon and Verizon Wireless, WC Docket No. 5-25 (February 24, 2010) at pp. 19, 29-30, 32-33; Comments of AT&T Inc., WC Docket 05-25 (January 19, 2010) at pp. 28-38; Comments of Qwest Communications International Inc., WC Docket 05-25 (January 19, 2010) at pp. 11-17.

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deregulated and which they still have over a decade later. It is also evident that the price-cap LECs are leveraging this dominance in the pricing that they charge the market, the term commitments they extract and the unilateral conduct they engage in. The lock-up practices engaged in by the price-cap LECs, analyzed in detail in our February 22, 2012 ex parte, enable and perpetuate all of the foregoing. Level 3 again urges the Commission to determine that demand lock-up arrangements have no place in the special access marketplace, particularly when employed by price-cap LECs with dominant shares of the market. Level 3 believes these price-cap LEC practices are pervasive, and are the primary issue holding back competition in the special access marketplace. We again urge the Commission to implement the remedies suggested in our February 22, 2012 ex parte.

Sincerely,

/s/

Michael J. Mooney

cc: (via courier)
Marvin Sacks

(via email)
Deena Shetler (Redacted Version)
Nick Alexander (Redacted Version)
Elizabeth McIntyre (Redacted Version)
Jamie Susskind (Redacted Version)
Andrew Mulitz (Redacted Version)
Daniel Shiman (Redacted Version)
Jonathan Reel (Redacted Version)
Marvin Sacks (Redacted Version)

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Exhibit A Part 1: Level 3 Competitive Carrier Purchasing Data

[BEGIN HIGHLY CONFIDENTIAL]

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Exhibit A Part 1: Level 3 Competitive Carrier Purchasing Data

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Exhibit A: Part 2

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Exhibit A: Part 3 - 1 of 2

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Exhibit A: Part 3 - 2 of 2

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1 [redacted] [END HIGHLY CONFIDENTIAL]

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Exhibit A: Part 4

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